In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

DAVID WARE, *et al.*,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California for the First Appellate District

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OPINION BELOW

The opinion of the Court of Appeal (App. 57-68) is reported at 24 Cal.App.3d 35, 100 Cal.Rptr. 791 (1972). No opinion was rendered by the Superior Court of the State of California, for the City and County of San Francisco.

JURISDICTION

The decree of the Court of Appeal for the First Appellate District affirming the order denying arbitration was

entered on March 15, 1972. (App. 57).[1] A timely petition for hearing in the California Supreme Court was denied on May 10, 1972.

On August 3, 1972 by order of Mr. Justice Douglas the time within which to file a petition for certiorari was extended to August 23, 1972. The petition was filed on August 23, 1972, and was granted on January 22, 1973. This Court's jurisdiction rests upon 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

1. Does a state law permitting actions for wages to be maintained notwithstanding private arbitration agreements interfere and conflict with federal law and policy when

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1. Both Respondent and the United States as *amicus curiae*, in their opposition to the petition for writ of certiorari, suggested the court of appeal's decision was not a final judgment for purposes of review by way of certiorari under 28 U.S.C. § 1257. They rely on *Baltimore Contractors, Inc. v. Bodinger*, 348 U.S. 176 (1955). There, however, the district court found no agreement to arbitrate. Here the court of appeals did find an agreement. Moreover, recent decisions of this Court suggest limitations on the *Baltimore Contractors* rationale.

In *Mercantile Nat'l Bank v. Langdeau*, 371 U.S. 555 (1963), this Court invoked its jurisdiction over a Texas Supreme Court order improperly interpreting a federal statute dealing with venue of actions against national banks. The Court believed "that it serves the policy underlying the requirement of finality in 28 U.S.C. § 1257 to determine *now* in which state courts appellants may be tried rather than to subject them, and appellee, to long and complex litigation which may all be for naught if consideration of the preliminary question of venue is postponed until the conclusion of the proceedings." 371 U.S. at 558. The same logic applies here. It makes little sense, particularly in considering the expeditious and economic effect of arbitration, to remit this action to a trial and subsequent review if arbitration is the proper forum to resolve the dispute. Arbitration is an issue wholly separate from and independent of the merits such as to satisfy finality requirements. See, *e.g., Local No. 438, Construction & General Laborer's Union v. Curry*, 371 U.S. 542 (1963). The practical importance of a prompt decision on the federal question is sensible and must be reconciled with a literal interpretation of finality under section 1257. In addition, an important national policy would be frustrated by denial of review at this juncture.

applied to deny arbitration between an employer and former employee who have entered into a written arbitration agreement required by a New York Stock Exchange rule which was promulgated as part of the federal self-regulatory scheme authorized by Congress in section 6 of the Securities Exchange Act of 1934?

2. Does the application of a state antitrust law, declaring void any contract by which a person is restrained from engaging in a lawful occupation to a provision in a profit-sharing plan of a national securities dealer providing for forfeiture of vested interests if an employee voluntarily terminates his employment and is employed by a competitor, constitute an impermissible burden on interstate commerce where the employer is engaged in interstate commerce in a federally regulated industry, where the plan operates in interstate commerce, where the plan requires equitable and uniform application, and where the provision is valid under the laws of other states and the laws of the United States?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 15:

> § 78*f*. *Registration of national securities exchanges.* (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents below specified:
>
> • • •
>
> (2) Such data as to its organization, rules or procedure, and membership . . .
>
> (3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange;"
>
> • • •

(c) Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this chapter and the rules and regulations thereunder, and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

§ *78bb. Effect on existing law.*

* * *

(b) Nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, . . .

§ *78cc. Validity of contracts.*

* * *

(2) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

California Business & Professions Code

§ *16600. Invalidity of Contracts.*

Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.

California Labor Code

§ 229. Actions to enforce payment of wages; effect of arbitration agreements.

Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate. This section shall not apply to claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement.

STATEMENT OF THE CASE

Respondent, a former employee of Merrill Lynch, filed an action on behalf of himself and other former California employees who had voluntarily terminated employment with petitioner and entered into employment with Merrill Lynch's competitors. He sought declaratory relief and damages, alleging that a provision of Merrill Lynch's profit-sharing plan was invalid under California Business & Professions Code section 16600. (App. 2-7). The plan provides that an employee who voluntarily terminates his employment and enters into employment with a competing stockbroker loses his interest in the plan. (App. 38).

Section 16600 of the Business & Professions Code makes void any contract by which an individual is restrained from engaging in a lawful occupation.

Merrill Lynch answered and raised various defenses, including the defense that application of California law deprived it of the benefits of due process and equal protection under the laws and Constitution of the United States, that its plan operated on an interstate basis, and that the forfeiture provision was valid under federal and New York law, the latter being a choice-of-law provision in the plan. (App. 45-50). It also petitioned for an order compelling

arbitration on the basis of a written agreement between it and respondent and all other members of the class. (App. 51-55). The arbitration agreement is contained in a Form RE 1 of the New York Stock Exchange. Rule 345 of the Exchange, of which Merrill Lynch is a member (App. 55-56), was promulgated pursuant to section 6 of the Securities Exchange Act of 1934 and requires registration of all persons employed as registered representatives, as were respondent and his class. (Appendix A to Brief). Rule 347(b) and the Constitution of the Exchange, also promulgated under the same statute, require arbitration of employment disputes between member firms and their employees. *Ibid.*

These points were raised in the trial court in a memorandum supporting the petition to compel arbitration and in a reply memorandum to respondent's opposition. (1 R. 135-37). Respondent opposed arbitration on the grounds that no contract existed, that if it did, it was adhesive and that, in any event, since section 16600 made the forfeiture provision illegal, he could not be required to arbitrate a contract in restraint of trade under California law. He also moved to determine the action be maintained as a class action. The trial court, by minute order, granted the class action motion and denied the petition to compel arbitration. (App. 57). It did not state any ground for the latter action even though requested to make findings of fact and conclusions of law. (1 R. 201). Merrill Lynch appealed that order.

On appeal, and without benefit of findings of fact or conclusions of law, Merrill Lynch challenged the order on all possible grounds, both state and federal. (2 R., Exhibit A). With respect to federal grounds, it contended that the self-regulatory scheme imposed by federal law in the Securities Exchange Act of 1934, including the delegation of authority to the Exchange and the Exchange's

promulgation of the arbitration rule, was paramount to state law (2 R., Exhibit A, pp. 33-35, 50), that state law could not be applied where interstate commerce was affected (2 R., Exhibit G, pp. 51-55), and that federal comity required state law to yield to federal supremacy in the antitrust and securities areas in order to achieve equitable and uniform application of federal arbitration policies (2 R., Exhibit A, p. 55).

On appeal the former employee, for the first time, asserted the bar of Labor Code section 229. (2 R., Exhibit B, pp. 30-31). After argument the court requested additional briefing (2 R., Exhibit D), including the application of Labor Code section 229. On the latter point, Merrill Lynch referred the court to its brief filed in the companion case (2 R., Exhibit E).[2]

The court of appeal, although agreeing a valid arbitration contract existed, rejected Merrill Lynch's contentions and relied primarily on California Labor Code section 229 which provides that actions for wages—the court equated profit-sharing benefits with wages—can be maintained without regard to arbitration agreements. (App. 57-68). It affirmed the order of the trial court and remitted the action for trial.

These federal contentions were again raised in a timely petition for hearing in the California Supreme Court. (2 R., Exhibit G). The California Supreme Court refused to hear these contentions. (2 R., Exhibit I).[3]

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2. Some five months earlier the same division of the Court of Appeal had reversed an identical order denying arbitration in an action brought by another employee against petitioner. *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal.App.3rd 668, 97 Cal.Rptr. 811 (1st Dist. 1971), (App. 69-74). The facts are identical and that employee, ostensibly a member of the class here, was ordered to arbitrate. Labor Code § 229 was also raised on appeal there but not applied in the court's opinion.

3. It also refused to resolve the direct conflict in opinions of the same court of appeal. See Note 2, *supra*.

SUMMARY OF ARGUMENT

1. Section 6 of the Securities Exchange Act of 1934 contains an express Congressional grant of rule-making authority to national stock exchanges. The exchanges have an obligation to enforce their rules. *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963). Pursuant to this federal mandate the New York Stock Exchange promulgated Rule 347(b) requiring arbitration of employment disputes between member firms and their employees. The rule is an integral part of the registration of employees who deal directly with the public and is designed to meet Congressional and industry concern over employment practices and relationships. The purpose of Rule 347(b) is to regulate those relationships, keep disputes out of court, and provide an expeditious and economical forum to resolve employment disputes through the medium of arbitrators familiar with industry custom and practice. A state law which precludes arbitration of employer-employee disputes in an action to recover profit sharing benefits conflicts and interferes with Rule 347(b) and the self-regulatory scheme. It frustrates Congressional purpose. Such an incompatible state law must give way in the face of the rule-making authority so as to prevent disparate results which may arise from application of state law, *e.g., Perez v. Campbell*, 402 U.S. 637 (1971), or from different treatment in state and federal forums, *e.g., Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). This is particularly true since federal courts have uniformly upheld the Rule 347.

It is true that a state may have an interest in preserving a judicial forum for its wage claimants just as Congress has an interest in preserving a judicial forum for investors. But Congress has in section 28 expressly approved arbitration as the forum for resolving disputes within the industry. That express approval is also evidence that Congress did

not intend a contrary result under state law for intra-industry disputes.

Finally Congress in section 6(c) also authorized exchange Rules to be consistent with New York law where the Exchange is organized. New York has no statute comparable to the California law on which respondent relies. Application of California law frustrates Congressional intent in this regard as well.

2. In a related case, *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 69), the court of appeals reversed an order denying arbitration. Section 16600 was there raised as a defense to arbitration. Implicit in that ruling is a finding that state law precluding arbitration of contracts restraining trade could not be applied to arbitration under Rule 347(b) because of its conflict with the federal regulatory scheme. The sole distinguishing feature in the court below was Labor Code section 229. The court erred in its application of Labor Code section 229 and, consistent with its prior opinion in *Frame*, arbitration should be ordered. To the extent section 16600 of the Business & Professions Code and state law barring arbitrations of illegal contracts can be construed as an alternative ground of decision, it too must fall under preemption principles for reasons applicable to section 229 and for additional reasons as well: (1) where federally mandated arbitration conflicts with state created rights, different considerations apply than when the concern is with competing policies at the federal level only are concerned; (2) recent federal decisions have upheld arbitration of employment disputes even in the face of federally created rights both under the federal antitrust laws and federal securities laws; and (3) the prior and contrary holding in *Frame* indicates the state's policy considerations are not strong.

Neither *Wilko v. Swan*, 346 U.S. 427 (1953) or *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963) warrant a contrary result. *Wilko*, to the extent it involves special statutory rights which may be considered parallel to section 16600, dealt with *express* Congressional intent to preclude waiver of these rights. Under section 28 a contrary intent appears when dealing with intra-industry disputes. In addition Respondent is not a member of the class designated for protection. The concern in *Silver* as to the total lack of a forum is not present either. Nor are the special circumstances generally considered to make arbitration inappropriate for resolution of antitrust claims. Factors generally thought to preclude arbitration can be accommodated under the California arbitration statute and Exchange rules.

3. The Merrill Lynch Profit Sharing Plan operates on a national level, open to all eligible employees wherever located. Its registered representatives' activities are interstate in nature and contemplate interstate activities. Provisions similar to Article 11.1 are valid and enforceable in other jurisdictions and do not present cognizable federal antitrust claims. *E.g., Austin v. House of Vision, Inc.*, 404 F.2d 401 (7th Cir. 1968). The net effect of the decision below requires compliance with the most stringent standard in order to achieve desired and equitable uniformity in the operation of the Plan. State antitrust law does not apply to either the Plan or the employment relationship because of its interstate nature. *E.g., Kosuga v. Kelly*, 257 F.2d 48 (7th Cir. 1958), *aff'd on other grounds*, 358 U.S. 516 (1959). Section 16600, ostensibly local in operation, is not local in effect and impedes the uniformity required by the interstate nature of the activities involved. As such, it unduly burdens commerce. *E.g., Bibb v. Navajo Freight Lines*, 359 U.S. 520 (1959); *Flood v. Kuhn*, 407 U.S. 258 (1972).

ARGUMENT

I.

California Labor Code Section 229 as Applied to an Arbitration Agreement Between a New York Stock Exchange Member Firm and Its Former Employee Conflicts and Interferes with Rule 347(b) of the Exchange Promulgated Under the Authority of Section 6 of the Securities Exchange Act of 1934.

A. INTRODUCTION.

Section 229 of the California Labor Code prohibits arbitration of wage disputes between employer and employee if the employee elects to sue for such wages, unless arbitration is required by a collective bargaining agreement. In contrast, Rule 347(b) of the New York Stock Exchange, promulgated under section 6 of the Securities Exchange Act of 1934, requires arbitration of employment disputes between member firms and their employees.

This case presents in part the question of the constitutionality of the California statute as applied to prohibit arbitration between a member firm and its former employees' claims to recover the monetary value of their rights in the employer's profit sharing plan which were forfeited when the employee voluntarily terminated his employment and went to work for a competitor.

Respondent Ware was employed by petitioner Merrill Lynch in 1958 at its San Francisco, California office in the capacity of a registered representative.[4] Merrill Lynch is a member of the New York Stock Exchange which is registered under section 6 of the Securities Exchange Act of 1934. Act of June 6, 1934, c. 404, § 6, 48 Stat. 885, 15 U.S.C. § 78f.

Rule 345 of the Exchange (App. A to Brief) requires the registration with, and approval by, the Exchange of any

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4. Merrill Lynch designates its registered representatives as "account executives." For purposes of consistency, the term "registered representative" as used in the Exchange Rules will be utilized.

person employed as a registered representative. On September 26, 1958, respondent Ware executed a written application for approval of employment as a registered representative on Form RE-1 of the Exchange and was subsequently approved and registered. (App. 55-56). In becoming registered representative Ware agreed to submit to the jurisdiction of the Exchange. (App. 56). On April 17, 1958 the Exchange had adopted Rule 347(b), which required that any controversy between a registered representative and any member firm arising out of his employment or its termination shall be settled by arbitration in accordance with the Exchange arbitration procedure. (App. A to Brief). Paragraph 30(j) of the RE-1 Form executed by Ware set forth the arbitration language of Rule 347(b). (App. 56).

In March 1969 Ware voluntarily terminated his employment with Merrill Lynch and became employed with a competing broker-dealer and member of the Exchange. As a Merrill Lynch employee, Ware was eligible to participate in its Profit-Sharing Plan For Employees. (App. 8-44). All contributions to the plan were made by Merrill Lynch, and were credited to Ware's account in the Profit Sharing Trust Fund.

Article 11.1 of the plan provides:

> "A participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation. . . and engages in an occupation which is in the determination of the Committee, competitive with the Corporation . . . shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960." (App. 38).

On April 18, 1969 the Administrative Committee determined that Ware had voluntarily terminated his employ-

ment with Merrill Lynch and entered into competitive employment. The Committee thereupon caused to be forfeited the rights Ware had in the plan. (App. 52).

Subsequently, Ware, on behalf of himself and all other former Merrill Lynch employees in California brought a state class action for declaratory judgment that Article 11.1 of the Merrill Lynch Profit Sharing Plan was illegal under Section 16600 of the California Business Code, and for damages in the amount of their forfeited interests in the plan. Merrill Lynch alleged, and there is no dispute, that all members of the class had executed similar or identical RE-1 Forms containing the arbitration agreement, had voluntarily left Merrill Lynch and become employed with competitors, and, as a result, had forfeited their interests in the plan.

The trial court's ruling denying arbitration was made by minute order (App. 57), and without the benefit of findings of fact and conclusions of law, although Merrill Lynch had requested them. (1 R. 201). The court of appeal, citing its prior decision in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal.App.3d 668, 97 Cal.Rptr. 811 (1st Dist. 1971) (App. 69-74), determined that a written agreement to arbitrate did exist (App. 61-64), but held that California Labor Code section 229 precluded arbitration.

B. WHEN CONSIDERED UNDER THIS COURT'S RECENT PREEMPTION DECISIONS, SECTION 229 IS AN OBSTACLE TO THE FULFILLMENT OF THE CONGRESSIONAL OBJECTIVES UNDER A FEDERAL REGULATORY SCHEME.

In considering cases involving preemption questions this Court has developed and followed a framework designed to fulfill the Court's function "to determine whether a challenged state statute 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives

of Congress.'" *Perez v. Campbell*, 402 U.S. 637, 649 (1971), quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

The decision making process under the *Hines* test is a two-step process as outlined in *Perez*. First, the construction of the statutes in question is ascertained and, second, a determination is made as to whether they are in conflict in the Constitutional sense. *Perez v. Campbell*, 402 U.S. at 644.

Section 229 of the California Labor Code was adopted in 1959. Cal.Stats. 1959, Ch. 1939, § 1, p. 4532. Prior to the present case no California court had construed section 229. Finding the intent to be "quite clear," the court of appeals indicated that "while the strong public policy of the State favors arbitration . . . the intent of the statute is to provide in the first instance a judicial forum where there exists a dispute as to wages." (App. 66) (citation omitted). Having determined this "clear intent," the court then equated profit sharing benefits with "wages" as used in the the statute and concluded that the statute barred arbitration notwithstanding the arbitration agreement. This Court is bound by the court of appeals ruling as to the construction of the statute, *e.g.*, *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335, 337 (1944), even though it is not the authoritative construction apparent in *Perez*.

On the other hand, the authoritative construction of Rule 347(b) is apparent from recent federal cases, and from the nature of the self-regulatory scheme, as well as the Congressional purposes behind the 1934 Act.

In recent federal decisions, actions were brought by registered representatives to recover finder's fees, *Dickstein v. DuPont*, 320 F.Supp. 150 (D. Mass. 1970), *aff'd*, 443 F.2d 783 (1st Cir. 1971), commissions, *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715 (S.D.N.Y. 1972), and for alleged violations of Rule 10(b)-5 of the Act in the sale back to

Merrill Lynch of stock acquired in a stock option plan, *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, CCH Fed. Sec. L. Rep. ¶ 93742 (E.D. Pa. Jan. 19, 1973). In each of the above cases the employee had executed an RE-1 Form and agreed to arbitrate under Rule 347(b). In each case the employer sought arbitration under the United States Arbitration Act, Act of July 30, 1947, c. 392, 61 Stat. 671, 9 U.S.C. § 3, or state law.[5] Arbitration was opposed in *Dickstein* on the ground that the RE-1 Form violated the Sherman Act, Act of July 14, 1890, c. 708, 26 Stat. 289, 15 U.S.C. § 1; in *Rust* on the ground of duress; and in *Ayres* on the ground that section 29 of the Act precluded arbitration, *e.g., Wilko v. Swan*, 346 U.S. 427 (1953).

In each instance, relying in part on *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), these courts ordered arbitration. Their collective rationale can be summarized as follows: (1) Under section 6 Congress gave broad rule-making powers to the exchanges, and all rules had to be approved by the Securities Exchange Commission as fulfilling the object of fair dealing and investor protection; (2) Rule 347(b) comes within the rule-making grant because of the Exchange's legitimate interest in deciding how disputes between its members and their employees are to be resolved, and in fostering harmonious relationships among the varied groups whose daily activities play a role in the complex operations of the Exchange and the industry; (3) Congress evidenced specific approval of the Exchange's arbitration rules by exempting them under section 28(b) from the nonwaiver provisions of section 29(a); and (4) the nature of the employment relationship and the practices

5. *E.g., Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715, 716 (S.D.N.Y. 1972) (N.Y.C.P.L.R. § 7501). The United States Arbitration Act and the New York and California Acts are virtually identical in terms.

peculiar to the Exchange suggest the reasonableness of prompt and economic arbitration by those experienced in trade practices and customs.

Arbitration pursuant to related New York Stock Exchange rules (*e.g.*, Rule 481) and the Exchange constitution (N.Y.S.E. Constitution Art. VIII) has also been consistently enforced by federal courts in disputes between members or members and nonmembers.[6] The analysis made by these federal courts support the arbitration rules in both a positive and negative sense. As to the latter each noted that since the principal purpose of the 1934 Act was for the protection of investors, Congressional policy was not thwarted by enforcing arbitration between members, members and nonmembers, employees of members, or similar combinations pursuant to exchange rules. On the positive side these courts observed that the supervised system of self-regulation not only *requires* the adoption of rules by exchanges but imposes an obligation of rule enforcement on them as well. See SEC, Report of Special Study of Securities Market, H. R. Doc. No. 95, 88th Cong., 1st Sess., Pt. I, p. 3; *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963).[7] Failure to enforce the arbitration rules frus-

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6. See *e.g.*, *Brown v. Gilligan, Will & Co.*, 287 F.Supp. 766 (S.D.N.Y. 1968); *Isaacson v. Hayden, Stone, Inc.*, 319 F.Supp. 929 (S.D.N.Y. 1970); *Coenen v. R. W. Pressprich & Co.*, 329 F.Supp. 1296 (S.D.N.Y. 1971), *aff'd.* 453 F.2d 1209 (2d Cir.), cert. *denied*, 406 U.S. 949 (1972); *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971); *Revenue Properties Litigation Cases v. Cohn, Delaire & Kaufman*, 451 F.2d 310 (1st Cir. 1971).

7. That an Exchange Rule has the force of law seems fairly well accepted. *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178 (2d Cir.), *cert. denied*, 358 U.S. 817 (1966); *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969); *cf.*, *Silver v. New York Stock Exchange*, 353 U.S. at 365. See generally Lowenfels, *Implied Liabilities Based On Stock Exchange Rules*, 66 COLUM.L. REV. 12 (1966); Note, *Private Actions As a Remedy For Violations of Stock Exchange Rules*, 83 HARV. L. REV. 825 (1970).

trates that policy, *e.g.*, *Coenen v. R. W. Pressprich & Co.*, 453 F.2d 1209, 1212 (2d Cir. 1972) *cert. denied*, 406 U.S. 949 (1972).[8]

This Court's decision in *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), sheds substantial light on Congressional intent and the statutory scheme. Recognising that Congress clearly intended to create a "federally mandated duty of self-policing by exchanges," the Court referred to section 6 as the source of authority for the delegation, 373 U.S. at 352. Mr. Justice Goldberg concluded that part of the statutory duty is an obligation "to formulate rules governing the conduct of exchange members and that section 6(d)'s requirement that an exchange's rules be 'just and adequate to insure fair dealing and to protect investors' has obvious relevance to the area of rules regulating the conduct of an exchange's members." 373 U.S. at 353. In evaluating the Congressional purpose the Court noted that arbitration, particularly involving nonmembers was not only "important" but deliberately designed to fulfill the section 6(b) and 6(d) duties. 373 U.S. at 353-54 & n. 9.

The fact that respondent here is not a "member" of the exchange is not relevant, as the court of appeals noted. (App. 61-64). It is an unavoidable result of including rules governing member-nonmember relationships under the Exchange's power to self-regulate, 373 U.S. at 356.

Congressional intent can also be gleaned from the overall regulatory scheme imposed under the Securities Exchange Act of 1934 and the language of section 6 itself. Prior to 1934 the securities industry was in large part unregulated by government. Congressional enactment in 1934 of the Act, and subsequent enactment of other statutes

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8. The Commission itself takes the position that the Exchange rules govern all member dealings, *even those not related to Exchange transactions*. E.g., 5 Loss, Securities Regulation 3138-39 (Supp. 1969).

dealing with the industry, did not however, result in a total displacement of the historical process of self-regulation; rather it continued it through a statutory scheme of self regulation supervised by the Commission.

Section 6 mandates the registration of exchanges and enforcement of rules and by-laws promulgated by them. Copies of the exchange constitution, articles, rules and by-laws must be submitted to the Commission pursuant to section 6(a)(3). If the Commission finds the exchange is organized so as to comply with the Act and its rules and regulations, and that the rules of the exchange "are just and adequate to insure fair dealing and to protect investors," the exchange is then registered. By the terms of the Congressional grant in section 6(d) Commission silence in 1958 when Rule 347(b) was adopted is authoritative approval of the Rule as meeting the statutory standard.

In addition to the plain statutory language and the Congressional intent as articulated in *Silver*, there is other evidence that Congress did, and continues to, intend the exchange's function to include the type of rule embodied in Rule 347(b).

Section 6(c) of the Act permits an exchange to adopt and enforce any rule not inconsistent with the Act, its rules or regulations, or "the applicable laws of the State in which it is located." The implication in this section is that Congress intended to supersede the law of other states. The New York Stock Exchange is a corporation organized under the laws of New York. 2 CCH N.Y.S.E. Guide, p. 2101. New York has an arbitration statute identical to that of California. *Compare* N.Y.C.P.L.R. § 7501 (McKinney 1963), *with* California Code of Civil Procedure § 1281. New York does not, however, have a provision in its labor laws comparable to section 229, although it does have laws relating to wages, *e.g.* N.Y. Labor Law § 198 (McKinney 1972 Supp.). Thus,

Rule 347(b) is entirely consistent with section 6(c) of the Act, and applicable New York law. Cf. *Rust v. Drexel Firestone Inc.*, 352 F.Supp. 715, 718 (S.D.N.Y. 1972).

That employment practices and relationships were and are of concern to both the Securities Exchange Commission and Congress is not only clear from the act, but from continuing observations of both entities. See, *e.g.*, Securities Exchange Act Release No. 34-9908 (Dec. 14, 1972), CCH FED.SEC.L.REP. ¶ 79141 (non-discrimination in employment). In 1964 when Congress enacted amendments to the 1934 Act based upon the Special Study, Act of Aug. 20, 1964, § 7, 78 Stat. 574, 15 U.C.S. § 78o-3, one important area in which it acted involved improved qualifications and controls for broker-dealers and their employees. See, *e.g.*, *H.R.* Rep. 1418, 88th Cong. 2d Sess. 3-4 (1964).

It is true that the 1934 Act, and other federal securities legislation contain provisions reserving the jurisdiction of state securities commission and "other rights and remedies that may exist at law or in equity." *E.g.*, Act of June 6, 1934, c. 404, § 28, 48 Stat. 903, 15 U.S.C. § 78bb(a). Section 28, however, is not the general type of savings clause ordinarily required to defeat a preemption or supremacy argument. See, *e.g.*, *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947). Nor should it be so interpreted in the face of the policies and purposes behind section 6, the need for national uniformity, the lack of a traditional area of state regulation, and the direct conflict between Labor Code section 229 and Rule 347(b).

Having been mandated a self-regulatory scheme, the Exchange has fulfilled its duty in part by adopting Rule 347(b) to cover disputes between member firms and their employees. Rule 347(b) contains nothing antithetical to the general policies sought to be furthered in the Act. On the

dealing with the industry, did not however, result in a total displacement of the historical process of self-regulation; rather it continued it through a statutory scheme of self regulation supervised by the Commission.

Section 6 mandates the registration of exchanges and enforcement of rules and by-laws promulgated by them. Copies of the exchange constitution, articles, rules and by-laws must be submitted to the Commission pursuant to section 6(a)(3). If the Commission finds the exchange is organized so as to comply with the Act and its rules and regulations, and that the rules of the exchange "are just and adequate to insure fair dealing and to protect investors," the exchange is then registered. By the terms of the Congressional grant in section 6(d) Commission silence in 1958 when Rule 347(b) was adopted is authoritative approval of the Rule as meeting the statutory standard.

In addition to the plain statutory language and the Congressional intent as articulated in *Silver*, there is other evidence that Congress did, and continues to, intend the exchange's function to include the type of rule embodied in Rule 347(b).

Section 6(c) of the Act permits an exchange to adopt and enforce any rule not inconsistent with the Act, its rules or regulations, or "the applicable laws of the State in which it is located." The implication in this section is that Congress intended to supersede the law of other states. The New York Stock Exchange is a corporation organized under the laws of New York. 2 CCH N.Y.S.E. Guide, p. 2101. New York has an arbitration statute identical to that of California. *Compare* N.Y.C.P.L.R. § 7501 (McKinney 1963), *with* California Code of Civil Procedure § 1281. New York does not, however, have a provision in its labor laws comparable to section 229, although it does have laws relating to wages, *e.g.* N.Y. Labor Law § 198 (McKinney 1972 Supp.). Thus,

Rule 347(b) is entirely consistent with section 6(c) of the Act, and applicable New York law. Cf. *Rust v. Drexel Firestone Inc.*, 352 F.Supp. 715, 718 (S.D.N.Y. 1972).

That employment practices and relationships were and are of concern to both the Securities Exchange Commission and Congress is not only clear from the act, but from continuing observations of both entities. See, *e.g.*, Securities Exchange Act Release No. 34-9908 (Dec. 14, 1972), CCH Fed.Sec.L.Rep. ¶ 79141 (non-discrimination in employment). In 1964 when Congress enacted amendments to the 1934 Act based upon the Special Study, Act of Aug. 20, 1964, § 7, 78 Stat. 574, 15 U.C.S. § 78o-3, one important area in which it acted involved improved qualifications and controls for broker-dealers and their employees. See, *e.g.*, *H.R.* Rep. 1418, 88th Cong. 2d Sess. 3-4 (1964).

It is true that the 1934 Act, and other federal securities legislation contain provisions reserving the jurisdiction of state securities commission and "other rights and remedies that may exist at law or in equity." *E.g.*, Act of June 6, 1934, c. 404, § 28, 48 Stat. 903, 15 U.S.C. § 78bb(a). Section 28, however, is not the general type of savings clause ordinarily required to defeat a preemption or supremacy argument. See, *e.g.*, *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947). Nor should it be so interpreted in the face of the policies and purposes behind section 6, the need for national uniformity, the lack of a traditional area of state regulation, and the direct conflict between Labor Code section 229 and Rule 347(b).

Having been mandated a self-regulatory scheme, the Exchange has fulfilled its duty in part by adopting Rule 347(b) to cover disputes between member firms and their employees. Rule 347(b) contains nothing antithetical to the general policies sought to be furthered in the Act. On the

contrary it is entirely consistent with and in furtherance of the Exchange's section 6 duties.

The promotion of the policy of insuring fair dealing and protecting investors is also served by the rule. It regulates the relationship between member firms and their employees, the latter being more closely associated directly with the investing public as representatives of member firms. Rule 345(a)(1) of the Exchange requires registration and approval of these representatives, prescribes a training program, examination, investigation and certain other matters. See, *e.g.*, 2 CCH N.Y.S.E. Guide ¶ 2345. Rule 346 prescribes limitations on their duties. These rules, together with Rule 347(b), all relate to the Exchange's duty to protect the investing public, as required by the Act. The most logical manner in which to promote that objective is to exercise the rule-making function over the employment relationship. It is those employees who assist the investing public in securities transactions. Congress attributed many of the market abuses which the 1934 Act was designed to prevent to these employees. The 1964 amendments to the Act evidenced continuing Congressional concern in this area. Failure to give full effect to these rules transgresses legislative policy.

An additional, and fundamental concern, is the lack of uniformity which would result from upholding the application of Labor Code section 229.

Self-regulation would be thwarted by permitting arbitration under the laws of one state, *e.g.*, *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715 (S.D.N.Y. 1972), but not in another such as California. To paraphrase *Perez*, to uphold section 229 would obviously be to legislate in such a way that the self-regulatory grant in rule 347(b) means one thing in one state and something else in other states—depending on state law—a result implicitly prohibited by

the uniform nature of the self-regulatory grant in the 1934 Act. Conflicting interpretation, as here and as in *Rust*, stimulates judicial disputes and impedes resolution of conflicts by other means. Lack of uniform treatment makes the need for uniformity in the area particularly compelling. Such uniformity can only come by permitting the arbitration provisions of the Exchange rules to prevail over inconsistent local laws. One cannot impute to Congress an intent that Exchange rules promulgated under section 6 might not be uniform in application, particularly since the Exchange's role in the regulatory scheme is "uniquely important." SEC, Report of Special Study of the Securities Market, H.R. Doc. No. 95, 88th Cong., 1st Sess. pt. 4, at 570 (1963); *Silver v. New York Stock Exchange*, 373 U.S. 341, 349 (1963). Within its sphere of authority (i.e., rulemaking) it occupies a position similar to, if not equally important as, the Securities Exchange Commission. As such, its rules should be capable of enforcement on a uniform basis. See, *e.g.*, *Schwabacher v. United States*, 344 U.S. 182 (1948).

If section 6 meant nothing more than that an exchange should draft rules incapable of enforcement, there would have been no purpose for the inclusion of section 6(a)(3) in the Act. *Cf. Bright v. Philadelphia-Baltimore-Washington Stock Exchange*, 327 F.Supp. 495 (E.D. Pa. 1971). One cannot impute to Congress an intent to draft a meaningless statute.

California's adoption of section 229 to provide the employee an election of forums is not a matter of traditional local concern, where the employer is engaged in interstate commerce in a national industry and where Congress has given the Exchange the authority to govern its internal affairs. Under section 301 of the Labor Management Relations Act, Act of June 23, 1947, c. 120, § 301, 61 Stat. 156, 29 U.S.C. § 185(a), this Court has held that the issue of

arbitrability of a dispute must be resolved by the application of federal substantive law fashioned by federal courts. See, *e.g., Textile Workers Union v. Lincoln Mills*, 353 U.S. 448 (1957). In such a case "incompatible doctrines of local law must give way to principles of federal labor law," *Local 174 Teamsters, etc. v. Lucas Flour Co.*, 369 U.S. 95, 102 (1962). Although the 1934 Act does not itself command arbitration as does the Labor Management Relations Act, Congress has, in section 6, expressly authorized exchanges to promulgate rules and regulations, and has indicated that such rules may and should govern the employment relationship within the securities industry. Having promulgated Rule 347(b) consistent with that grant of power, it should be entitled to enforcement as a matter of federal substantive law in the same manner as arbitrations are enforced in the federal labor law context or under the United States Arbitration Act, Act of July 30, 1947, c. 392, 61 Stat. 670, 9 U.S.C. §§ 1 *et seq.*; see, *e.g., Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960); *Dickstein v. Dupont*, 320 F. Supp. 150 (D. Mass. 1970), *aff'd*, 443 F.2d 783 (1st Cir. 1971).

This Court and lower federal courts have consistently endorsed the suitability of arbitration to resolve federally-created rights, *e.g., Wilko v. Swan*, 346 U.S. 427 (1953) (dictum); *Coenen v. R. W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972) (violation of Securities Exchange Act, Sherman, and Clayton Acts).[9] There is even more reason to do so here.

The court of appeal's construction of section 229 in effect preserved the right of a wage claimant to sue in California

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9. A number of other cases are collected in Mr. Justice White's dissenting opinion in *U.S. Bulk Carriers, Inc. v. Arguelles*, 400 U.S. 351, 374-75 (1971).

notwithstanding an arbitration agreement. Respondents are not uncompensated wage claimants but highly compensated employees engaged in a specialized occupation and utilizing confidential information supplied them by the Exchange, the employer, and their customers. Implicit in the court's construction is a theory that section 229 precludes waiver of the right to bring a judicial action for relief. A similar provision is contained in section 29(a) of the 1934 Act, Act of June 6, 1934, c. 404, § 29, 48 Stat. 903, 15 U.S.C. § 78cc(a). A similar section in the 1933 Act has been interpreted by this Court as precluding arbitration of a claim arising under the Act by a customer against a broker-dealer. See, *e.g., Wilko v. Swan*, 346 U.S. 427 (1953). Underlying the Court's determination was the intent of the 1933 Act to protect investors, 346 U.S. at 435. An analogy can be made to Labor Code section 229 insofar as it was designed to give California wage earners a right to a judicial forum in the first instance.

Unlike *Wilko*, however, respondents are not investors who need protection from the industry. To the investing public respondents are in a real sense the industry itself. As employees of members who are required to be registered and approved by the exchanges, they stand in a similar position as members. Permitting arbitration between them does not defeat the legislative policy, particularly where no statutory securities violations are alleged over which the non-waiver provision would apply.

There is an even more fundamental reason for giving effect to the arbitration provision in the face of a federal non-waiver statute. Section 28(b) of the 1934 Act, Act of June 6, 1934, c. 404, § 28(b), 48 Stat. 903, 15 U.S.C. § 78bb (b), exempts from the non-waiver provisions of section 29(a), "any action taken by the . . . exchange to settle disputes between its members" and also "with regard to the

binding effect of such action on any person who has agreed to be bound thereby." The exchange arbitration rules have been consistently interpreted by federal courts as falling within both the Congressional purpose of self-regulation *and* "action" within the meaning of section 28(b).[10] To permit a state statute which can be characterized as a non-waiver provision to overcome an exchange rule would emasculate section 28(b) and fail to give it effect. It would also result in divergent federal and state decisions depending upon the forum in which the action was brought. If Congress did not intend the federal nonwaiver statute, section 29(a), to overcome the arbitration of disputes under exchange rules exempt from section 29(a) by section 28(b), it surely did not intend a contrary result if the nonwaiver statute were predicated on state law, such as Labor Code section 229.

Laws delegating extensive regulatory powers to administrative agencies are fundamentally different from other types of laws. See, *e.g.*, *San Diego Building Trades Council v. Garmon*, 359 U.S. 236 (1959). In such circumstances, present here, the task of the judicial process is not to make ad hoc determinations based on a particular set of circumstances to ascertain the precise nature of the conflict, but rather to deal with "classes of situations. 359 U.S. at 241. Where Congress has entrusted the administration of the securities industry to centralized agencies, utilizing specialized knowledge, experience and procedure, private activities subject to such regulation should be subject only to the federal scheme; state laws imposing conflicting requirements are presumptively invalid, even if they could also be imposed by federal agencies or quasi-administrative agencies such as the Exchange. Federal statutes delegating broad regulatory authority, as section 6 of the Act, are

10. See cases cited note 6, *supra*.

entitled to the special weight and different considerations exemplified by these federal decisions. See also *Campbell v. Hussey*, 368 U.S. 297 (1961); *Public Util. Comm'n v. United States*, 355 U.S. 534 (1958). The reliance by Congress on the self-regulatory scheme creates the conflict, but Congress alone has that choice. Rule 347(b) of the Exchange fulfills that goal in the area where investor protection is most acute. To permit state law to interfere and conflict with Rule 347(b) frustrates that policy and stands as the "obstacle to the accomplishment and execution of the full purposes and objectives of Congress" under *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

A further reason for application of uniform national treatment to the exclusion of conflicting state law is to prevent the fundamental unfairness that arises from forum shopping.

Had Ware brought his action in federal court based on diversity of citizenship[11] the petition to compel arbitration and to stay proceedings could have been based upon the United States Arbitration Act, Act of July 30, 1947, c. 392, 61 Stat. 670, 9 U.S.C. §§ 1 *et seq.* (1970). See, *e.g.*, *Dickstein v. DuPont*, 320 F.Supp. 150 (D. Mass. 1970), *aff'd*, 443 F.2d 783 (1st Cir. 1971). Section 2 of the Act provides that agreements to arbitrate future disputes are "valid, irrevocable, and enforceable, save upon such grounds as exist at

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11. 28 U.S.C. § 1332 (1970). Ware and his class are California residents. (App. 3). Merrill Lynch is organized outside of California with its principal place of business in New York. (App. 51). Ware's action not only seeks declaratory relief but also seeks to recover each employee's interest in the plan. (App. 6). No amount is alleged and is not required under the California Declaratory Relief Statute, California Code of Civil Procedure § 1060 *et seq.* Discovery has not yet determined the amount in controversy but the possibility exists that removal under 28 U.S.C. § 1441 (1970) arguably exists, *e.g.*, *Fleming v. Colonial Stores, Inc.*, 279 F.Supp. 933 (S.D. Fla. 1968), at least as to some of the class members, *e.g.*, *Snyder v. Harris*, 394 U.S. 322 (1969).

law or in equity for the revocation of any contract." This language is identical with the California arbitration statute upon which the petition was based here. California Code of Civil Procedure § 1281.

Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960), declared in dictum that Section 2 was both national in scope and equally applicable in state or federal court. *Id.* at 407. It also found that Congress intended by the Act to establish "federal substantive law affecting the validity and interpretation of arbitration agreements." *Id.* at 406[12]

In reaching its conclusion that the Act established federal substantive law, the court in *Robert Lawrence Co.* answered a question left open by this Court's decision in *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956). *Bernhardt* involved a diversity action for damages for discharge under an employment contract containing an arbitration clause. The contract was to be performed in Vermont where a statute permitted revocation of an arbitration agreement at any time before an award. Applying *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), the district court followed Vermont law and denied the stay. The court of appeals reversed. Mr. Justice Douglas' opinion for the majority held that the Act was inapplicable since the contract did not evidence a transaction involving commerce. *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 200-201 (1956).

If the Act is purely procedural, contrary "outcome determinative" state law would be controlling in diversity

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12. The Act was originally passed in 1925 to remedy three problems: 1) delays incident to litigation in congested courts; 2) expense of litigation; and 3) the failure through litigation to reach a just result measured by business standards. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924); Committee on Trade, Commerce & Commercial Law, *The United States Arbitration Act and Its Application*, 11 A.B.A.J. 153, 155-56 (1925).

cases. *Robert Lawrence Co.* avoided this result by construing section 2 as the source of substantive law. As such the states are bound to apply it under the Supremacy Clause. See *e.g.*, Note, *Erie, Bernhardt and Section 2 of the United States Arbitration Act: A Farrago of Rights, Remedies, and a Right to a Remedy*, 69 YALE L.J. 847 (1960); Note, *The Federal Arbitration Act In State Courts: Converse Erie Problems*, 55 CORNELL L. REV. 623 (1970).

This reasoning was implicitly adopted by this Court in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). *Prima Paint* brought a diversity action to rescind a consulting agreement containing an arbitration clause, for alleged fraud in the inducement of the contract. The defendant had requested arbitration of the dispute. Finding the commerce requirement applicable and relying on *Lawrence*, the Court agreed that the issue of fraud in the inducement of the contract was a question for the arbitrators *as a rule of federal substantive law, even in the face of contrary state law.* 388 U.S. at 399-400.

The Court then fashioned a rule of federal substantive law based upon Congressional purpose and intent. It held that in passing upon a motion to stay pending arbitration "a federal court may consider only issues relating to the making and performance of the agreement to arbitrate." 388 U.S. at 404.

This type of claim was raised in the trial court and before the court of appeal (App. 61-64), just as it was in *Rust v. Drexel Firestone Inc.*, 352 F.Supp. 715 (S.D.N.Y. 1972) (duress), and in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 71-72). The court of appeals held that an arbitration agreement existed under California law. (App. 61). Since the California Act is identical to the federal act, a similar result would be reached in federal court under *Robert Lawrence Co.* and *Prima Paint*. But,

contrary to the court of appeals decision, the inquiry would have stopped there and arbitration been ordered under *Prima Paint*, notwithstanding Labor Code section 229. Given the strong federal policy in favor of arbitration, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. at 404, a state court should concern itself chiefly with fostering uniformity of result in state or federal court by giving effect to the federal right substantially as would a federal court, which is exactly what the court did in *Frame*. Fortuity of suit in a state court rather than a federal court should not lead to divergent results, particularly where section 3 of the Arbitration Act permits reliance on the Act or applicable state law. See, *e.g.*, *United States ex rel. Capolino Sons, Inc. v. Electronic & Missile Facilities, Inc.*, 364 F.2d 705 (2d Cir.), *cert. denied*, 385 U.S. 924 (1966). To do otherwise gives an unfair advantage to the litigious party.

II

Except for Labor Code Section 229 the Court of Appeals Would Have Ordered Arbitration Having Implicitly Recognized as It Did in Frame v. Merrill Lynch That Application of Business and Professions Code Section 16600 to Prohibit Arbitration Because of the Underlying Illegality of the Noncompetition Clause Conflicts and Interferes with Rule 347(b).

In *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 69-74) the court of appeals reversed the order denying arbitration. Merrill Lynch there had raised the same preemption arguments that are raised here. The *Frame* court, however, "did not consider the effect of section 229 . . . on the arbitration agreement." (App. 66). Section 229, therefore, is the only distinguishing feature in the two cases and except for that section the court below undoubtedly would have reversed the trial court and ordered arbitration. Respondent also agrees that section 229 was the sole basis in distinguishing the cases. (2 R., Exhibit H).

In disposing of the issue of arbitrability both courts examined Article 11.1 in light of section 16600 of the Business & Professions Code. In both cases it was argued that Article 11.1 was illegal under *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal.2d 239, 42 Cal.Rptr. 107 (1965),[13] and that arbitration would not lie to enforce an illegal contract.[14] Nevertheless,

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13. *Muggill* involved a noncompetition clause in a pension plan. The employee retired and was then employed by a competitor. The action sought reinstatement in the plan after the forfeiture occurred.

14. *E.g., Loving & Evans v. Blick*, 33 Cal.2d 603, 204 P.2d 23 (1949) (unenforceability of arbitration award on a contract claim by unlicensed contractor); *Alpha Beta Food Markets, Inc. v. Amalgamated Meat Cutters*, 147 Cal.App.2d 343, 305 P.2d 163 (2d Dist. 1956) (denial of arbitration under collective bargaining agreement where agreement allegedly violated state and federal antitrust law).

the *Frame* court ordered arbitration. The only logical interpretation that can be placed on the *Frame* decision is that application of section 16600 to bar arbitration because of illegality conflicted and interfered with Rule 347(b); hence, state law could not be applied with respect to the issue of arbitration. Had it decided otherwise there would have been no reason for the court below to consider Labor Code section 229. Moreover, if the court below was in fact *also* holding that section 16600 barred arbitration, it would presumably have expressly overruled *Frame*. That it did not do so, but relied exclusively on section 229, indicates that it agreed with the necessary implications that follow from *Frame*, including the implication that section 16600 does not, indeed cannot, bar arbitration under Rule 347(b).

Like *Perez*, the expression of state policy is clear. Both *Frame* and *Ware* should be construed in this manner: upholding the arbitration under Rule 347(b) in the face of section 16600. Thus, the only proper issue before the Court here concerns the application of section 229, and it too must fall under preemption doctrines.

It will undoubtedly be argued, however, that section 16600 also precludes arbitration. Assuming this alternative theory is suitable for consideration, section 16600 stands in no different posture than section 229 and should receive similar treatment, particularly where *Frame* makes it clear that section does not represent such a *strong* public policy that might otherwise overcome the preemption hurdle. The same arguments applicable to section 229 can also be directed at section 16600. In addition, other considerations militate against holding section 16600 constitutional insofar as the

opinion below may be construed to apply it as a state law bar to federally mandated arbitration under Rule 347(b).

The relationship of the securities acts and federal antitrust law have been considered both by this court and others. See, *e.g., Silver v. New York Stock Exchange*, 373 U.S. 341 (1963).[15] None of these cases have involved the juxtaposition of arbitration and antitrust policies where the arbitration was based on a Congressional grant of authority as section 6 of the 1934 Act, and the antitrust policy was state created.[16] Rather, they involved competing federal statutes and competing Congressional policies. Here the competing policies are at different levels—federal and state.

The relationship also distinguishes cases in which arbitration has been generally held inappropriate. See, *e.g., American Safety Equip. Corp. v. J. P. Maguire Co.*, 391 F.2d 821 (2d Cir. 1968). There the court was concerned with federal antitrust laws and an arbitration agreement contained in a licensing agreement. Here the conflicting policies

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15. See also, *Ricci v. Chicago Mercantile Exchange*, ... U.S. ..., 93 S.Ct. 573 (1973); *Harwell v. Growth Programs, Inc.*, 451 F.2d 240 (5th Cir. 1971), *cert. denied* sub nom. *N.A.S.D. v. Harwell*, ... U.S. ..., 93 S.Ct. 126 (1972); *Cowan v. New York Stock Exchange*, 256 F.Supp. 462 (S.D.N.Y. 1966), *aff'd*, 371 F.2d 661 (2d Cir. 1967); *Kaplan v. Lehman Bros.*, 250 F.Supp. 562 (N.D. Ill. 1966), *aff'd*, 371 F.2d 409 (7th Cir. 1967), *cert. denied*, 389 U.S. 954 (1968); *Thill Sec. Corp. v. New York Stock Exchange*, 283 F.Supp. 289 (E.D. Wis. 1968), *rev'd*, 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971).

16. *Aimcee Wholesale Corp. v. Tomar Prods., Inc.*, 21 N.Y.2d 621, 289 N.Y.S.2d 968 (1968), cited below, did involve a conflict between an arbitration clause and a claim under New York's Donnelly Act, but the arbitration clause was injected into the sales contract by agreement of the parties, not because it was required under the authority of a Rule adopted under a power expressly delegated by a legislative authority.

are state laws dealing with restraints[17] and federally mandated self-regulation which has resulted in Rule 347(b). Congress clearly intended exchanges to take the initiative in drafting rules under section 6 of the Act. While competing Congressional purposes may present difficult issues of conflict resolution, no difficulty arises when the conflict is with a state policy. The threat of state antitrust laws such as section 16600 militates against the initiative given the exchanges and, if allowed to prevail, would create an uncertainty as to their legitimacy which would disrupt the scheme.

Nor is there any question that arbitration of disputes runs contrary to any other federal or state policy. Congress in many instances, such as the federal labor laws and the Federal Arbitration Act, has recognized the value of arbitration. California also has a strong public policy favoring arbitration as the court below recognized. (App. 66). Rule 347(b) is consistent with, and enhances those policies. Where the parties have made the arbitration process available for resolution of issues, it is sound and consistent with general approbation of those policies to require it, rather than litigation.

Recent federal cases since *Silver* have also upheld the arbitration rules of the Exchange in the face of federal antitrust complaints, *e.g., Coenen v. R. W. Pressprich & Co.*, 329 F.Supp. 1296 (S.D.N.Y. 1971), *aff'd*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972), or actions alleging violations of the 1934 Act itself, *e.g., Ayres v. Merrill*

17. Respondent has asserted throughout these proceedings that section 16600 is not an antitrust law. While not part of the specific California antitrust law commonly referred to as the Cartwright Act, Business & Professions Code § 16700 *et seq.*, it is part of the statutory scheme to preserve and regulate competition, and may generally be considered a state antitrust law in that sense. See, *e.g.*, Van Kalinowski & Hanson, *The California Antitrust Laws: A Comparison With the Federal Antitrust Laws*, 6 U.C.L.A. Rev. 533, 535-540 (1959).

Lynch, Pierce, Fenner & Smith, Inc., CCH FED.SEC.L.REP. ¶ 93696 (E.D. Pa. Jan. 19, 1973). In *Ayres* the employee's claim was an alleged violation of section 10(b) of the Act in the sale to Merrill Lynch of its stock purchased by him under its stock option plan. The employee was thus in a dual capacity of employee and investor, and the court emphasized the nature of the employment relationship and Rule 347(b). The same rationale applies here. The requirement of arbitration arises out of Rule 347(b). Section 10(b) of the Act, as the court recognized, was of significant and fundamental importance to the operation of the statute. As such, it is as much in the public interest as a state created antitrust right, at least where the right affects individuals involved in a regulated industry and where Congress authorized the Exchange to promulgate rules affecting its members and their employees.[18] Since the Exchange has acted, its rule should not be limited by that alleged state public interest. Moreover, as the *Ayres* opinion notes, and as was recognized in *Frame* (App. 73-74), those questions of public interest are not beyond the province of the arbitrators.

Merrill Lynch recognizes that the *Coenen* decision was predicated in part on the fact that the agreement to arbitrate was made after the dispute arose. A close analysis of the facts in the opinion, however, reveals that neither party was aware of the dispute until after the agreement to arbitrate had been made. Here the controversy (i.e., Article 11.1 of the Plan vis-a-vis section 16600 of the California Business & Professions Code) was present as in *Coenen*, before the arbitration agreement was executed, or simultaneous with its execution. Ware did not become sub-

18. *Cf. Humble Oil & Refining Co. v. Independent Indus. Workers*, 337 F.2d 321 (5th Cir. 1964) (arbitration appropriate under collective bargaining agreement even though complaint alleged unfair labor practice charge).

ject to either Article 11.1 or arbitration until he became an employee. Both obligations were requirements of his employment with Merrill Lynch in the securities industry. As the Special Study authorized by Congress pointed out, deep deficiencies existed in the minimum standards of competency and integrity of industry employees. It suggested that the "gateway to the industry is where government and industry should look first for the solution," since salesmen are the link between the public and member firms. SEC, Report of Special Study of the Securities Market, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2 (1963). Exchange rules dealing with the employment relationship are designed to meet the problem upon which the Special Study focused. For example, Exchange rule 345 concerns itself not only with registration, but with training and competence. The Study described a wide range of practices ranging from good to no training at all, and concluded that the responsibility rested with individual firms. As respondent Ware admitted here (1 R. 170-171) he participated in the Merrill Lynch training program designed to fulfill the obligations of Rule 345[19] and curb the abuses apparent not only in 1934 but as late as 1963. The purpose of investor protection is fulfilled by the very language of the RE-1 Form itself (1 R. 63-67), which obligates the employee to follow practices designed to protect the investor. The arbitration agreement is part of these obligations. (App. 55-56).

The Exchange, in its self-regulatory role, has a legitimate interest in deciding the manner in which disputes between its members and their employees are resolved, and in promoting harmonious relations among those persons and entities who have the operational role in dealing with the investing public. It is not unreasonable to require those

19. An explanation of the training program is set forth in the Exchange's supplementary information to Rule 345, see, *e.g.*, 2 CCH N.Y.S.E. Guide ¶ 2345.10-.17.

engaged at that critical point to resolve their disputes by prompt and economic arbitration rather than drawn out litigation, *e.g.*, *Wilko v. Swan*, 346 U.S. at 431-32; *Prima Paint Corp. v. Flood & Conklin Mfg. Co. Inc.*, 388 U.S. at 404.

Although it has been said that arbitration is inappropriate for resolution of antitrust issues, *e.g.*, Pitofsky, *Arbitration and Antitrust Enforcement*, 44 N.Y.U.L.Rev. 1072 (1969), in the absence of concrete statistical analysis, this view is speculative. See *e.g.*, Aksen, *Arbitration and Antitrust: Are They Compatible?* 44 N.Y.U.L.Rev. 1097 (1969). The typical justification for judicial reluctance to utilize the arbitration process for such claims ignores reality. For example, if fraud in the inducement of a contract is a permissible issue to submit to arbitration, *e.g.*, *Prima Paint Corp. v. Flood & Conklin, Mfg. Co.*, 388 U.S. 395, there is no reason to believe that antitrust issues are not equally appropriate. Concern over limited discovery in arbitration is vitiated, at least insofar as the California Arbitration Act is concerned, which makes all statutory tools of civil discovery available in arbitration proceedings. See, *e.g.*, California Code of Civil Procedure §§ 1282.6, 1283, 1283.1. Concern that arbitrators are "not bound by rules of law," *e.g.*, *Wilko v. Swan*, 346 U.S. at 436-37, ignores the fact that arbitrators called upon to decide antitrust issues would presumably review applicable law. And the determination of the arbitrators would be reviewable to insure that a "manifest disregard" of the law has not occurred. *Wilko v. Swan*, 346 U.S. at 436; *Cf. Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 74). That arbitrators should decide the questions initially was the basis of the decision by the court of appeals in the *Frame* case. (App. 73-74). It obviously believed that arbitration of these issues was appropriate and did not offend any state policy. Finally, arbitration here offers an economical and workable vehicle for the resolution of issues requiring intimate familiarity

with features of the securities industry. Moreover, if the alleged restrictive practice is to fall, a decision by arbitrators to that effect is far more consistent with, and more meaningful to, the self-regulatory scheme than imposition of external controls.

Wilko v. Swan, 346 U.S. 427 (1953), does not suggest otherwise. There an investor, a member of the primary class of persons which the 1934 Act was designed to protect, had executed an arbitration agreement when he opened a margin account with the broker-dealer. The broker-dealer sought arbitration in an action for damages under section 12(2) of the Securities Act of 1933, Act of May 27, 1933, c. 38, § 12(2), 48 Stat. 74, 15 U.S.C. § 77 l. This Court held the arbitration agreement invalid relying primarily on the *express* Congressional intent in section 14 of the Act declaring any "stipulation" waiving compliance with the Act void. Section 14 is identical with section 29 of the 1934 Act. *Wilko* is predicated upon the special right to recover for misrepresentation. But it also recognized that arbitration of statutory rights was both possible and desirable. 346 U.S. at 432 & n. 13.

Respondents here are not investors. Moreover, as discussed in Part I of this Brief, section 28 of the 1934 Act carves out an exemption to the non-waiver provisions of section 29 insofar as the binding effect of Exchange rules designed to settle disputes is concerned. Unlike *Wilko* there is no express or implied Congressional intent to protect member-firm employees qua employees comparable to the non-waiver provisions in section 29, or any special right conferred upon them. Indeed, both section 6 and section 28 imply a Congressional intent to the contrary by authorizing Exchange rules such as Rule 347(b) to be promulgated.

In *Wilko* this Court was concerned with the fact that Congress sought to stimulate and encourage private enforcement by public investors by giving them special statutory

rights with liberal choices of forum and ease of proof. 346 U.S. at 430-31. While section 16600 arguably imports the same concern on the state level, the additional liberality factors are not present.[20] Even if those considerations were present they are not diminished by arbitration. The Exchange rules permit arbitration in California, and Merrill Lynch has so agreed. (2 R., Exhibits D, E, F). In addition, factual resolutions are facilitated by arbitrations, as *Frame* noted. (App. 74).

The *Frame* court realized that *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal.2d 239, 42 Cal.Rptr. 107 (1965), did not purport to change established California Code law interpreting section 16600. In addition to noting that issues of fact could appropriately be decided by arbitrators, it also referred issues of law to them, including the construction of Article 11.1 of the Plan. (App. 74). The *Frame* court undoubtedly had in mind cases like *Gordon v. Landau*, 49 Cal.2d 690, 321 P.2d 456 (1958), upholding an agreement not to use confidential customer lists for one year after termination of employment in the face of a challenge under section 16600. Other California cases make similar nonstatutory exceptions even though Business and Professions Code sections 16601 *et seq.* appear to be the exclusive exceptions. See generally Briody, *Employment Agreements Not To Compete In California*, 47 Cal. State Bar J. 318 (1972). These questions, as *Frame* recognized, are best resolved by industry arbitrators who are better equipped to evaluate Article 11.1 of the Plan because they are familiar with the circumstances involved and the nature of industry needs.

Although directed at the administrative process, Mr. Justice White's observations in *Ricci v. Chicago Mercantile Exchange*, ... U.S. at ....., 93 S.Ct., at 582, are relevant.

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20. Section 16600 does not create any special forum for litigation, or simplify methods of proof, nor does it permit treble damages, although the same are permitted for other state antitrust violations, *e.g.*, Business & Professions Code § 16750 (a).

In dealing with rules of the mercantile exchange, his opinion for the Court suggests that questions about the "scope, meaning and significance" of exchange rules should be initially decided by persons familiar with industry custom and practice. The same rationale applies here to the arbitration process, as perceived by the court of appeals in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 73-74).

A decision by this Court that Rule 347(b) must be followed by a California court does not necessarily foreclose judicial scrutiny of the antitrust claim, as the court of appeals noted in *Frame*. Its result is a striking parallel to this Court's decision in *Ricci*, as both Mr. Justice White and the Chief Justice noted, ... U.S. at ....., ..., 93 S.Ct. at 582, 583-84.

The Court's opinion in *Silver* also does not require the result reached here. The application of *Silver* to an exchange rule of long standing[21] is qualitatively different from its application to a single instance of enforcement. The *Silver* concern—a total lack of a forum—is not present here. The forum question should be viewed as a policy consideration, not a question of statutory construction. Congressional policy gave the Exchange authority to promulgate rules. Rule 347(b) has not "plainly exceeded" that authority, as *Silver* requires to overturn a rule, 373 U.S. at 365, and as such is entitled to enforcement over any conflicting state law, whether it be antitrust or otherwise. The frustrating effect of section 16600, as with section 229, takes the form of rendering meaningless the procedural provisions of the regulatory scheme. The broad grant of authority in section 6 indicates Congress wishes the exchange to have broad responsibility for the regulation of the industry more or less undisturbed by judicial policies on competition, arbitration, or conflicts between the two at

21. *Crimmins v. American Stock Exchange*, 346 F.Supp. 1256, 1271 (S.D.N.Y. 1972) (arbitration rules in force since 1934).

this particular level of federal-state relationships. To hold otherwise permits section 16600 to be the obstacle to the accomplishment and execution of the self-regulatory scheme in section 6.

III

Application of Business and Professions Code Section 16600 to the Employment Relationship and the Profit Sharing Plan Which Require National Uniformity Unduly Burdens Commerce.

The Merrill Lynch Profit Sharing Plan operates on a national and international level, open to all eligible Merrill Lynch employees wherever located. (App. 49-50). Their employment was interstate in nature, as is Merrill Lynch's business, and their activities affect interstate commerce and contemplate use of the facilities of interstate commerce. See, *e.g.*, *Prima Paint Corp. v. Flood & Conklin Mfg. Co., Inc.*, 388 U.S. at 401; *Dickstein v. DuPont*, 320 F.Supp. at 153. A number of states which have considered similar provisions under related state antitrust statutes or common law restraint of trade principles have upheld the legality of the provision, including New York whose law was intended to be the operable law for application. See, *e.g.*, *Kristt v. Whelan*, 5 N.Y.2d 807, 155 N.E.2d 116 (1958).[22] Others, like California, have held such provision illegal.[23] Under federal law, no court has yet construed such a provision to raise the issue of a Sherman Act violation. See, *e.g.*, *Austin v. House of Vision, Inc.*, 404 F.2d 401 (7th Cir. 1968); *Graham v. Hudgins, Thompson, Ball & Assoc., Inc.*, 319 F.Supp. 1335 (N.D. Okla. 1970).

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22. See also *Van Pelt v. Berefco, Inc.*, 60 Ill.App.2d 415, 208 N.E.2d 858 (1965) (applying Massachusetts law). Other states have upheld noncompetition clauses without discussion of restraint of trade principles, *e.g.*, *Flynn v. Murphy*, 350 Mass. 352, 215 N.E. 2d 109 (1966); *Stopford v. Boonton Molding Co.*, 56 N.J. 169, 265 A.2d 657 (1970); *Garner v. Girard Trust Bank*, 442 Pa. 166, 275 A.2d 534 (1971).

23. *E.g.*, *Estate of Schroeder v. Gateway Transp. Co.*, 53 Wisc. 2d 59, 191 N.W.2d 860 (1971) (statute permitting reasonable restrictions).

The net effect of the court of appeals decision requires Merrill Lynch to comply with the most stringent standard. The thrust of the court's decision is that while Merrill Lynch may still have a uniform plan, it must be a plan complying with California law. Such a plan would deprive Merrill Lynch of the benefits of the laws of the greater number of states in which the provision is legal, and of the right to insist that its personnel who have access to confidential business information or who develop close relationships with customers, and whom Merrill Lynch has trained, will not utilise such information or relationships in competition with Merrill Lynch. Even in those states where a similar provision has been held to be invalid under state law, the statute does not necessarily vitiate any provision. For example, the Wisconsin statute referred to in *Estate of Schroeder v. Gateway Transp. Co.*, 53 Wis.2d 59, 191 N.W.2d 860 (1971), permits reasonable restraints. Yet because of section 16600 Merrill Lynch is forced to have a plan complying with California law even though it may comply with not only laws of states which validate the provision generally but also those which validate it under limited circumstances.

Although the court below was concerned over the effect of its decision vis-a-vis non-California employees, Article 11.1 contains no intrastate limitations. Ware's benefits would have been forfeited and redistributed to other employees whether or not Ware entered into competitive employment in or out of California. Its operation is more than intrastate in nature, thus drawing into question the applicability of the state law.

The natural, rational result of the exercise of Congressional power under the federal antitrust laws is to avoid the development of multiple standards in measuring interstate violations. While states may legislate as to local trade, their power stops there. *Cf. United States v. Frank-*

fort Distilleries, 324 U.S. 293, 298 (1945). When the issue has been squarely raised, courts have uniformly and expressly rejected contentions that state antitrust laws apply to transactions involving interstate commerce. See, *e.g.*, *Kosuga v. Kelly*, 257 F.2d 48 (7th Cir. 1958), *aff'd on other grounds*, 358 U.S. 516 (1959). This doctrine has also been followed in state courts, *e.g.*, *Vendo Co. v. Stoner*, 105 Ill. App.2d 261, 245 N.E.2d 263 (1969); *State v. Milwaukee Braves, Inc.*, 31 Wis. 2d 699, 144 N.W.2d 1 (1969).

Section 16600 also is not the type of legislation where the "propriety of local regulation has been long recognized," as in health and safety statutes. *Southern Pac. Co. v. Arizona*, 325 U.S. at 796 (Douglas, J., dissenting). While it may promote legitimate state interests, even where a state pursues a clearly legitimate local interest the burden on interstate commerce may exceed permissible limits.

The employment agreement here, while primarily focused in California, was never expressly or impliedly so limited. As Congress itself realized when it enacted the securities legislation, interstate commerce is regularly used and vitally affected by broker dealers in servicing the investing public. That a registered representative is involved in such commerce is readily apparent. See, *e.g.*, *Dickstein v. DuPont*, 320 F.Supp. at 153. Ware's employment was not the typical traditional state regulated local activity. He was expected to service Merrill Lynch clients wherever located and that activity clearly contemplated, as a minimum, use of interstate communication and travel facilities (*cf.* 1 R. 170-71). Compare *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. at 401. Since his employment was interstate in nature as to execution and performance, it cannot be tested by state standards. That relationship does not admit of diverse treatment since state and local law unduly burden the nature of the enterprise involved. See, *e.g.*, *Flood v.*

Kuhn, 316 F.Supp. 280, 281 (S.D.N.Y. 1970), *aff'd*, 443 F.2d 264, 267 (2d Cir. 1971), *aff'd*, 407 U.S. 258, 284 (1972). Yet that is exactly the effect of the decision below on the Merrill Lynch plan.

Merrill Lynch recognizes that the existence of the power in the federal government to regulate interstate commerce under the Commerce Clause does not exclude all state regulation. See, *e.g.*, *Southern Pac. Co. v. Arizona*, 325 U.S. 761, 766-67 (1945). But here, where the regulation of an ostensibly local matter is not local in effect and its impact on national commerce does interfere with its operation, the competing local demand should not be permitted to prevail. *Bibb v. Navajo Freight Lines*, 359 U.S. 520 (1959).

CONCLUSION

For the foreging reasons it is respectfully submitted that the order and decision of the court below should be reversed.

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Appendix A

New York Stock Exchange Rule 345.

Employees—Registration, Approval, Records, Discipline.

Rule 345. (a) No member or member organization shall

(1) permit any person to perform regularly the duties customarily performed by a registered representative, unless such person shall have been registered with and is acceptable to the Exchange, or

(2) employ any registered representative or other person in a nominal position because of the business obtained by such person.

(b) No member corporation shall permit any person to assume the duties of an officer unless such corporation has filed an application with and received the approval of the Exchange.

(c) The Exchange may disapprove the employment of any person.

(d)(1) If the Exchange determines that any employee or prospective employee of a member or member organization (1) has violated any provision of the Constitution or of any rule adopted by the Board of Governors, (2) has violated any of his agreements with the Exchange, (3) has made any misstatement to the Exchange, or (4) has been guilty of (i) conduct inconsistent with just and equitable principles of trade, (ii) acts detrimental to the interest or welfare of the Exchange, or (iii) conduct contrary to an established practice of the Exchange, the Exchange may withhold, suspend or withdraw its approval of his employment by a member or member organization; may fine such employee or prospective employee $5,000 for each such violation, misstatement, or act or omission for which he has been found guilty; and may direct that he be censured. The Exchange shall disclose publicly withdrawals of approval or suspensions of employees and former employees. The Exchange may in its discretion, disclose publicly censures

and fines, censures or fines. The total of the fines which may be imposed upon any employee or prospective employee at any one time shall not exceed $25,000 except as provided in Rule 345(e).

(2) An accusation, charging a registered representative, non-registered employee or prospective employee with having committed a violation shall be in writing; it shall specify the charge or offense with reasonable detail and inform the person charged that he is entitled to request an appearance before a panel of the staff of the department bringing the charges. A copy of the charge or charges shall be served upon the person charged by delivering or by mailing it to him at his office address or at his place of residence. The person charged shall have ten days from the date of such service to answer the same, or such further time as the Exchange may deem proper. The answer and request for an appearance shall be in writing, signed by the person charged and filed with the department bringing the charge. A panel composed of three members of the department shall meet to consider the charge or charges. Notice of this hearing shall be sent to the said person charged; he shall be entitled to be present personally to examine and cross-examine all witnesses produced before said panel and also to present such testimony, defense, explanation or witnesses as he may deem proper. If said person charged should decline, refuse or neglect to request a personal appearance at this hearing, the determination of the panel shall be made on the basis of the charges and the written answer, if any, of the person charged. After hearing all witnesses and the person charged, if he desires to be heard, the panel shall determine whether the person charged is guilty of the offense or offenses. Notice of the finding and the penalty imposed by the Exchange and that such person may require a review by the Board of Governors in accord-

ance with Rule 345(e), shall be mailed to said registered representative, non-registered employee or prospective employee in the manner hereinbefore provided.

(e) Any present or prospective employee of a member or member organization may require a review by the Board of Governors of any determination and penalty made under this Rule by filing with the Secretary of the Exchange a written demand therefor within 20 days after such determination and penalty has been rendered. As a result of any such review the Board may sustain any determination and penalty imposed, may modify or reverse any such determination, and may increase, decrease or eliminate any such penalty, or impose any penalty, as it deems appropriate. The determination and penalty, if any, as approved by the Board following its review shall be final and conclusive.

(f) If any employee of a member or member organization is suspended or expelled from any other securities exchange or any national securities association, or is suspended or barred from being associated with any member of such exchange or association or is suspended or barred by any governmental securities agency from dealing in securities or being associated with any broker or dealer in securities, the Exchange may in view of such suspension, expulsion or bar, suspend or withdraw its approval of his employment by a member or member organization, but no such suspension by the Exchange shall commence before or expire after the suspension imposed by such other exchange, association or agency, and no such withdrawal of approval shall be imposed by the Exchange unless such employee has been expelled or barred by such other exchange, association or agency. Nothing in this paragraph (f) shall preclude any proceeding against any employee under Rule 345(d)(2). In any proceeding under this paragraph (f), the method of procedure required by Rule

345(d)(2) shall not apply, but the employee shall be given not less than ten days notice in writing of a hearing before a panel of the staff of the Exchange to determine whether or not the Exchange should suspend or withdraw, as the case may be, its approval of his employment of a member or member organization, as provided herein. At such hearing, the employee shall be afforded an opportunity to explain why it would be inappropriate for the Exchange to suspend or withdraw its approval of his employment, notwithstanding his suspension, expulsion or bar by such other exchange, association or agency. In the event the employee fails or refuses to appear at such hearing, the Exchange may nevertheless determine the matter and suspend or withdraw its approval of his employment as provided herein. Notice of the Exchange's determination and that such person may require a review by the Board of Governors in accordance with Rule 345(e), shall be mailed to such employee in the manner provided in Rule 345(d)(2).

* * *

New York Stock Exchange Rule 345.17

Agreements.—Each prospective registered representative or officer shall sign the following statements:

(a) "I authorize and request any and all of my former employers and any other person to furnish to the Exchange, or any agent acting on its behalf, any information they may have concerning my credit worthiness, character, ability, business activities, general reputation, mode of living and personal characteristics, together with, in the case of former employers, a history of my employment by them and the reasons for the termination thereof. Moreover, I hereby release each such employer and each such other person from any and all liability of whatsoever nature by reason of furnishing such information to the Exchange or any agent acting on its behalf.

"Further, I recognize that I will be the subject of an investigative consumer report ordered by the Exchange and that I have the right to request complete and accurate disclosure by the Exchange of the nature and scope of the investigation requested.

(b) I authorize the New York Stock Exchange to make available to any prospective employer, or to any Federal, State or Municipal agency, any information it may have concerning me, and I hereby release the New York Stock Exchange from any and all liability of whatsoever nature by reason of furnishing such information.

(c) I agree that the decision of the New York Stock Exchange as to the results, of any examinations it may require me to take will be accepted by me as final, and that I shall be subject to the penalties provided for under Rule 345(c) of the Board of Governors, as from time to time amended, if, in the opinion of the Exchange, I have

(1) violated any provision of the Constitution or of any rule adopted by the Board of Governors;

(2) violated any of my agreements with the Exchange;

(3) made any misstatements to the Exchange; or

(4) been guilty of (i) conduct inconsistent with just and equitable principles of trade, (ii) acts detrimental to the interest or welfare of the Exchange, or (iii) conduct contrary to an established practice of the Exchange.

(d) I have read the Constitution and Rules of the Board of Governors of the New York Stock Exchange and, if approved, I hereby pledge myself to abide by the Constitution and Rules of the Board of Governors of the New York Stock Exchange as the same have been or shall be from time to time amended, and by all rules and regulations adopted pursuant to the Constitution, and by all practices of the Exchange."

Further, each registered representative, in consideration of the Exchange's approving his application, shall sign the following statements:

(A) "That I will not guarantee to my employer or to any other creditor carrying a customer's account, the payment of the debit balance in such account, without the prior written consent of the Exchange.

(B) That I will not guarantee any customer against loss in his account or in any way represent to any customer that I or my employer will guarantee the customer against such losses.

(C) That I will not take or receive, directly or indirectly, a share in the profits of any customer's account, or share in any losses sustained in any such account.

(D) That I will not make a cash or margin transaction or maintain a cash or margin account in securities or comodities, or have any direct or indirect financial interest in such a transaction or account, except with a member organization or with a bank. I understand and agree that no such transaction may be effected and no such account may be maintained without the prior consent of my employer, and that except for Monthly Investment Plan transactions such employer must receive promptly, directly from the carrying member organization or bank, duplicate copies of all confirmations and statements relating to such transactions or account. I further understand and agree that I shall receive no compensation for commissions or profits earned on any transaction or account in which I have a direct or indirect financial interest, except with the approval of my employer and in accordance with the rules of the Exchange.

(E) That I will not rebate, directly or indirectly, to any person, firm or corporation any part of the compensation I receive as a registered employee, and I will not pay such compensation, or any part thereof, directly or indirectly, to any person, firm or corporation, as a bonus, commission, fee or other consideration for busi-

ness sought or procured for me or for any member or member organization of the Exchange.

(F) That at any time, upon the request of the Department of Member Firms, or of any Committee or other Department of the New York Stock Exchange, I will appear before such Committee or Department and give evidence upon any subject under investigation by any such Committee or Department, and that I will produce, upon request of the Exchange, all of my records or documents relative to any inquiry being made by the Exchange.

(G) I understand that any changes in compensation in any form, or additional compensation in any form, may be subject to disapproval by the New York Stock Exchange, and that I may not be compensated for business done by or through my employer after the termination of my employment except as may be permitted by the Exchange.

(H) I agree that I will not take, accept, or receive, directly or indirectly, from any person, firm, corporation or association, other than my employer, compensation of any nature, as a bonus, commission, fee, gratuity or other consideration, in connection with any securities, commodities or insurance transaction or transactions, except with the prior written consent of the Exchange.

(I) I will notify my member organization and the Department of Member Firms promptly if, during the tenure of my employment I become the subject of: any investigation or proceeding by any governmental or securities or insurance industry self-regulatory body; a refusal of registration, injunction, censure, suspension, expulsion or other disciplinary action by any governmental or securities or insurance industry self-regulatory body; a major complaint by a customer of a member organization or by a broker-dealer in securities; a disciplinary action by a member organization; any litigation or arbitration alleging my violation of any agreement with or provision of any securities

industry self-regulatory body's constitution, by-laws, or rules or any securities or insurance law or regulation; or any bankruptcy or contempt proceeding, cease and desist order, injunction or civil judgment as party defendant; or any arrest, summons, arraignment, indictment, or conviction for a criminal offense (other than minor traffic violations); or any material allegation that I have conducted myself in a way which may be inconsistent with just and equitable principles of trade, or detrimental to the interest and welfare of the Exchange, or contrary to an established practice of the Exchange; or if I violate any provision of the Exchange Constitution or of any rule adopted by the Board of Governors or of any securities or insurance law or regulation or of any agreement with the Exchange.

(J) I agree that any controversy between me and any member or member organization or affiliate or subsidiary thereof arising out of my employment or the termination of my employment shall be settled by arbitration at the instance of any such party in accordance with the arbitration procedure prescribed in the Constitution and rules then obtaining of the New York Stock Exchange."

(K) If the Exchange, during the period of 90 days immediately following receipt by the Exchange off written notice of the termination of my employment gives me written notice that the Exchange is making inquiry into any specified matter or matters occurring prior to termination of such employment, I agree that I will thereafter, comply with any request of the Exchange for me to appear and testify, submit records, respond to written requests, attend hearings, and accept disciplinary charges or penalties with respect to the matter or matters specified in such notice in every respect in conformance with the Constitution, Rules and practices of the Exchange in the same manner and to the same extent as required to do if I had remained an employee. If I refuse to accept such written notice

or, having been given such notice, refuse or fail to comply with any such request of the Exchange, I agree that such refusal or failure may, in the discretion of the Exchange, act as a bar to future Exchange approval of my employment until such time as the Exchange has completed investigation into the matter or matters specified in such notice; has determined a penalty, if any, to be imposed against me; and until the penalty, if any, has been carried out.

New York Stock Exchange Rule 347.

Compensation.

Rule 347. (a) Pursuant to Section 1 of Article XV of the Constitution [¶ 1701], registered representatives may be compensated as follows:

(1) registered representatives—on a salary or a commission basis,

(2) branch office managers—on a salary or a commission basis: also, with the prior approval of the Exchange, they may receive a percentage of the net profit of the branch office,

(3) a registered representative who is also head of a department of the organization—may, with prior approval of the Exchange, receive a percentage of the net profit of his department, and

(4) bonuses—registered representatives may participate with the prior approval of the Exchange, in bonus distributions.

(b) Any controversy between a registered representative and any member or member organization arising out of the employment or termination of employment of such registered representative by and with such member or member organization shall be settled by arbitration, at the instance of any such party, in accordance with the arbitration procedure prescribed elsewhere in these rules.